

Auditor-General of South Africa

Umzinyathi District Municipality - Audit report 2016-17

Report of the auditor-general to the KwaZulu-Natal Provincial Legislature and the council on Umzinyathi District Municipality

Report on the audit of the financial statements

Adverse opinion

1. I have audited the financial statements of the Umzinyathi District Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, because of the significance of the matters described in the basis for adverse opinion section of this report, the financial statements do not present fairly, in all material respects, the financial position of the Umzinyathi District Municipality as at 30 June 2017, and its financial performance and its cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2016 (Act No. 3 of 2016) (DoRA).

Basis for adverse opinion

Infrastructure assets

3. The municipality did not recognise all items of infrastructure assets in accordance with SA Standard of GRAP 17, *Property, plant and equipment*. Completed assets were recognised as assets under construction and completed projects were not componentised and depreciated. Additionally, the useful lives for infrastructure assets were revised by management without estimating the period over which the asset was expected to be available for use. I was unable to determine the impact of this misstatement as it was impracticable to do so for the infrastructure assets stated at R1,82 billion and depreciation stated at R24,96 million in note 7 and note 27, respectively to the financial statements. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

Payables from exchange transactions – Retentions

4. The municipality did not recognise payables in accordance with SA Standard of GRAP 104, *Financial instruments*. The municipality did not record all retention monies withheld on progress payments made for construction contracts. In addition, the amount recorded in the financial statements did not reconcile to the creditors age analysis. I was unable to determine the impact of this misstatement as it was impracticable to do so for the payables stated at R67,45 million and infrastructure assets stated at R1,82 billion in note 13 and note 7, respectively to the financial statements.

Revenue from exchange transactions - Service charges

5. The municipality did not recognise all revenue from the service charges in accordance with SA Standard of GRAP 9, *Revenue from exchange transactions*. The amount of kilolitres used by the municipality to bill consumers did not agree to the actual meter readings. I was unable to determine the impact of this misstatement as it was impracticable to do so for the service charges stated at R44,11 million and consumer debtors stated at R193,10 million in note 18 and note 5, respectively to the financial statements. Additionally, there was a resultant impact on the surplus for the period and on the accumulated surplus.

General expenses

6. I was unable to obtain sufficient appropriate audit evidence for general expenditure due to the status of the accounting records. Supporting documentation did not have adequate information to determine whether all expenditure was properly recorded for water services operating costs and consulting and professional fees. I could not confirm this recorded expenditure by alternative means. Consequently, I was unable to determine whether any further adjustment to general expenses stated at R227,45 million (2015-16: R312,09 million) was necessary.

Water losses

7. I was unable to obtain sufficient appropriate audit evidence for water losses, due to inadequate systems and processes for the recording and monitoring of these losses. I was unable to confirm the water losses by alternative means. Consequently, I was unable to determine whether further any adjustments were necessary to water losses stated at R53,09 million in note 47 to the financial statements.

Context for the opinion

8. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this report.
9. I am independent of the Umzinyathi District Municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
10. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse opinion.

Emphasis of matter

11. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Material underspending of conditional grant

12. As disclosed in note 23 to the financial statements, the municipality materially underspent the regional bulk infrastructure grant by R29,54 million. This was due to the contracts of poorly performing contractors being cancelled.

Other matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

15. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA, DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
16. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the intention is to liquidate the municipality or cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

17. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
18. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

20. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
21. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2017:

Development priorities	Pages in the annual performance report
KPA 2 – Basic services delivery and infrastructure investment	18 – 20
KPA 4 – Good governance and public participation	27 – 30

22. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the usefulness and reliability of the selected development priority is as follows:

KPA 2 – Basic services delivery and infrastructure investment

Number of households to be provided with access to sanitation facilities within the Reconstruction and Development Programme (RDP) standards: Indicator not reliable

24. The reported achievement for the number of households to be provided with access to sanitation facilities within RDP standards was misstated as the evidence provided indicated an estimated 3 777 and not 5 395 as reported.

Number of households to be provided with access to water within RDP standards: Indicator not reliable

25. The reported achievement for the number of households to be provided with access to water within RDP standards was misstated as the evidence provided indicated an estimated 379 and not 647 as reported.
26. I did not identify any material findings on the usefulness and reliability of the reported performance information for the development priority: good governance and public participation.

Other matters

27. I draw attention to the matters below.

Achievement of planned targets

28. The annual performance report on pages xx to xx; xx to xx includes information on the achievement of planned targets for the year and explanations provided for the under/overachievement of a number of targets. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 24 and 25 of this report.

Adjustment of material misstatements

29. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of good governance and public participation and basic services delivery and infrastructure investment development priorities. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information for the basic services delivery and infrastructure investment development priority. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

30. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
31. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements

32. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors on infrastructure assets, general expenses, water losses, payables from exchange transactions and service charges in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving an adverse audit opinion.

Procurement and contract management

33. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by supply chain management (SCM) regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was reported in the prior year.

Expenditure management

34. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

35. Effective steps were not taken to prevent irregular expenditure of R244,10 million disclosed in note 44 to the annual financial statements, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by non-compliance with SCM regulations.
36. Effective steps were not taken to prevent fruitless and wasteful expenditure of R103 693 disclosed in note 43 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest and penalties charged on invoices paid late.

Consequence management

37. Some irregular expenditure and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Other information

38. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report which includes the mayor foreword, accounting officer's report and the audit committee's report. The other information does not include the financial statements, the auditor's report and those selected development priorities presented in the annual performance report that have been specifically reported in the auditor's report.
39. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
40. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected development priorities presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
41. I did not receive the other information prior to the date of this auditor's report. When I do receive and read this information, if I conclude that there is a material misstatement therein; I am required to communicate the matter to those charged with governance and request that the other information be corrected. If the other information is not corrected, I may have to retract this auditor's report and re-issue an amended report as appropriate; however, if it is corrected this will not be necessary.

Internal control deficiencies

42. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon.
43. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the adverse opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

44. Leadership did not adequately oversee financial and performance reporting and compliance with legislation. In this regard, leadership did not ensure that effective measures were taken to address previous findings to support the achievement of credible reporting and compliance with legislative requirements.

Financial and performance management

45. Management did not implement a proper records management system to maintain documents supporting reported performance information as well as revenue, asset and liability management.
46. Systems and controls were not designed in a manner that would prevent, detect and address risks that had an impact on financial; performance and compliance reporting. In this regard, management did not ensure that regular, accurate and complete financial and performance reports that were supported and evidenced by credible information were prepared.

Other reports

47. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
48. An independent consultant investigated an allegation of possible financial misconduct at the request of the municipality, which covered the period 01 July 2015 to 31 December 2016. The investigation was concluded on 11 August 2017 and resulted in criminal and civil proceedings against one official and a disciplinary proceeding against another official.
49. An independent consultant investigated an allegation of possible financial misconduct at the request of the municipality, which covered the period 12 December 2016 to 22 December 2016. The investigation was concluded on 22 June 2017 and resulted in criminal and civil proceedings against one official.
50. The provincial treasury investigated instances of irregular expenditure that covered the period 01 July 2011 to 30 June 2014. The investigation was concluded on 30 June 2017 and resulted in disciplinary proceedings against fifteen officials.

Auditor-General
Pietermaritzburg

30 November 2017



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected development priorities and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officers use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Umzinyathi District Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.